

Proposed revision:	Proposed revisions to Procurement Guidelines (PGs), Balancing Principles Statement (BPS) and Balancing Services Adjustment Data (BSAD) Methodology Statement – Incorporation of BM Start-Up Services		
Decision:	The Authority¹ agrees that National Grid Electricity Transmission PLC (NGET) may modify the PGs, BPS, and the BSAD Methodology Statement in line with Appendices A1, B and C of the Authority Report respectively²		
Target audience:	NGET and other interested parties		
Date of publication:	3 October 2006	Implementation Date:	1 November 2006³

Background to the proposed revisions⁴

In late 2004, NGET launched a review of its reserve procurement framework to determine whether the reserve arrangements could be enhanced to ensure that reserve is procured in an efficient and economic manner. In September 2005, following discussions and consultation with industry participants, NGET published a document outlining its conclusions and potential developments⁵. NGET's conclusions proposed to:

- ◆ Replace the Standing Reserve service, which allows NGET to secure reserve in annual blocks at the year-ahead stage via a tender process, with a STORT Short-Term Operating Reserve Tender (STORT) service, which would allow NGET to secure firm reserve availability for 3-4 month blocks up to two years in advance, with tenders issued on a quarterly basis.
- ◆ Replace the Supplemental Standing Reserve service, which allows NGET to procure reserve after the year-ahead stage and before day-ahead, with Additional Short-Term Operating Reserve Tender (ASTORT). This would allow additional tenders to be submitted at the week-ahead stage should it be efficient to secure additional firm reserve ahead of the day.

¹ The terms 'the Authority', 'Ofgem' and 'we' are used interchangeably in this document. Ofgem is the Office of the Gas and Electricity Markets Authority, the regulator of the gas and electricity markets in Great Britain.

² This document is notice of the reasons for this decision as required by section 49A of the Electricity Act 1989.

³ These changes will take effect from 1 November 2006 or such later date as shall be specified by NGET and notified to all interested parties as being the date upon which all necessary systems to enable implementation have been deployed successfully.

⁴ NGC is obliged under standard condition C16 of the transmission licence to have in place the following documents:

- ◆ The PGs, detailing the types of balancing services that NGC may be interested in purchasing, together with the mechanisms by which those balancing services will be procured;
- ◆ The BPS, defining the broad principles and criteria by which NGC will determine, at different times and in different circumstances, which balancing services it will use to assist in the operation of the transmission system; and
- ◆ The BSAD Methodology Statement, setting out the information on relevant balancing services that will be taken into account under the BSC for the purposes of determining Energy Imbalance Prices.

⁵ NGET's conclusions and background to the existing reserve arrangements can be found at:

http://www.nationalgrid.com/NR/rdonlyres/F66EE1F1-3CEB-4095-98AB-4E650EFC6811/1287/0905_ReserveReviewConclusions.pdf

- ◆ Replace the on-the-day reserve service of Warming and Hot Standby (WHSB)⁶ with a new service, called the Balancing Mechanism (BM) Start-Up service (described below).

The proposed revisions

In August 2006, NGET issued a consultation paper⁷ proposing to replace the WHSB service with a BM Start-Up service⁸. Details are provided below.

The proposed BM Start-Up service is similar to the current WHSB service in that it is designed to give the System Operator within-day access to generation units that would not have otherwise run and the could not be made available in BM timescales due to long lead times for example.

The key differences between the current WHSB service and the proposed BM Start-Up service are:

- ◆ Any provider can offer the BM Start-Up service, including the demand side, and not just oil and coal-fired generation.
- ◆ Generators can submit three availability rates (£/h) associated with different start-up times, to reflect the fact that the costs associated with starting units which are in different states of readiness may vary.
- ◆ Providers of the service will be able to change their availability fee on a weekly basis, with a price submission gate closure of 12:00 on Thursday to apply from 05:00 the following Monday.
- ◆ Availability fees will be paid to generators regardless of whether the unit proceeds to synchronisation (the start and cease instructions will define the period over which payment is made). This should mean that the offer price, paid to generators should the unit be synchronised, should reflect the incremental energy cost and not the full start up costs of warming the unit.

⁶ WHSB is a commercial ancillary service developed with the introduction of the New Electricity Trading Arrangements (NETA). It gives the System Operator within-day access to flexible oil and coal-fired generators that otherwise would not have run and which could not be made available in BM timescales (due to lead-times or other technical characteristics).

If NGET utilises a WHSB contract and instructs a unit to warm in anticipation of synchronising it to the system but subsequently decides that is no longer requires that unit to run, NGET is required to pay generator an availability fee, on a £/h basis, as set out in the WHSB contract. This availability payment covers the costs incurred by the generator in warming its unit (fuel costs for example). However, where the unit proceeds to synchronisation with the system the full costs associated with warming the unit and the any energy supplied to the system are solely recovered through the Balancing Mechanism offer price – no availability price is paid. The flexibility provided to NGET under the WHSB service to stand down units ensures that inefficiencies in running a generation units when they are not required is avoided.

The Hot Standby element of the Warming service allows NGET to hold a unit in a state of readiness to synchronise with the system following the issuing of a warming instruction. An additional payment is made to the unit for this service regardless of whether the unit proceeds to synchronisation or is stood down.

⁷ <http://www.nationalgrid.com/uk/Electricity/Balancing/consultations/>

⁸ NGET noted that the proposed changes to reserve services would be subject to separate consultations early in 2007.

- ◆ BM Start-Up availability fees will be included in the calculation of the Buy Price Price Adjuster (BPA) variable within BSAD⁹. These availability costs will be targeted across the settlement periods that drove the requirement to secure reserve, i.e. those periods in which NGET identified a shortfall in indicated generation availability to meet forecast demand including the reserve requirement.
- ◆ Information concerning NGET's utilisation of the BM Start-Up service will be updated on the SONAR website automatically and will include: agreement date and time, estimated capacity, instruction issued, earliest synch date and time, requirement periods, BM Start-Up price and indicative cost¹⁰.

NGET's recommendation

Following consideration of responses to its consultation, NGET recommends that the PGs, BPS, and the BSAD Methodology Statement are modified in line with Appendices A1, B and C of the Authority Report respectively. This is on the basis that NGET believes that the new BM Start-Up service will have significant benefits in terms of the efficient and economic operation of the GB transmission system, promotion of competition, and transparency. NGET recommended an implementation date of 1 November 2006.

The Authority's decision

The Authority has considered the issues raised by the consultation responses¹¹ and Authority Report in relation to the proposed introduction of the BM Start-Up service. The Authority has concluded that:

1. implementation of the BM Start-Up service will better facilitate NGET's ability to operate the system in an efficient, economic and co-ordinated manner in accordance with its licence¹², and
2. directing that the implementation be made is consistent with the Authority's principal objective and statutory duties¹³.

Reasons for the Authority's decision¹⁴

Economic and efficient procurement of reserve

The BM Start-Up service can be provided by all BMUs with lead-times that prevent them from starting-up within BM timescales, regardless of fuel type, thereby increasing the number of potential providers relative to the existing WHSB service. Consequently, we

⁹ The volume weighted average cost of BM Start-Up will be calculated by dividing the total cost of reserve by the total volume of reserve being created at each point in time, which when summed across all periods of the requirement will give a volume weighted average cost of reserve.

¹⁰ NGET request views on whether it was appropriate to publish price related information on SONAR and provided two versions of the Procurement Guidelines in its report to the Authority, one including provisions to allow price related information to be published and one without.

¹¹ The consultation responses can be found at:
<http://www.nationalgrid.com/uk/Electricity/Balancing/consultations/>

¹² Standard licence condition C16(1).

¹³ The Authority's statutory duties are detailed primarily in 3A – 3D of the Electricity Act 1989.

¹⁴ Ofgem notes that a significant number of the concerns raised by respondents to the consultation relate to the draft contract terms issued by NGET alongside the C16 consultation. These concerns have not been considered as part of Ofgem's decision, as they do not form part of the C16 consultation. However, Ofgem understands that NGET has been working with parties to enhance the contractual arrangements for the service and welcomes the commitment of all involved in this respect.

consider that the level of competition for the provision of on-the-day reserve services to NGET should increase. Other things being equal, we would expect increased competition to put downward pressure on the price of on-the-day reserve, leading to a reduction in the overall costs of balancing the system. Indeed, we note that NGET states that the introduction of the BM start-up service will have significant benefits in terms of the efficient and economic operation of the GB transmission system. Therefore, we expect that the BM Start-Up service will enhance the efficient and economic operation of the GB transmission system by NGET.

Impact on cash out prices

A number of respondents have suggested that costs associated with the proposed service should not be included in the calculation of imbalance prices. Ofgem continues to believe that option fees should be included in the calculation of energy imbalance prices and that all costs of balancing services should be appropriately targeted at those parties who are out of balance. This includes both the option and utilisation fees of reserve services contracted by NGET prior to purchases in the Balancing Mechanism. Ofgem continues to believe that there is strong economic rationale for signalling the total costs of availability fees through energy imbalance. Further, Ofgem believes that the proposed treatment of availability fees is consistent with the treatment of other reserve services such as Standing Reserve where the option fee feeds into the cash out price calculation.

Under the current warming service, where a unit is synchronised in the BM, the availability fee and any utilisation costs are recovered in the offer prices across the Minimum Non-Zero Time (MNZT). Under the BM Start-Up service, costs of balancing services will only be included in those periods identified by NGET as having driven the BM Start-Up notice to be issued. We believe that it is appropriate that the costs of BM Start-Up are incorporated into the relevant period(s) that drove the requirement and targeted at those parties in imbalance during these periods. This ensures that parties who are out of balance are appropriately exposed to the costs that NGET has incurred in balancing the system, thereby providing commercial incentives for parties to balance their positions. Other things being equal, this should improve the overall system balance, enhancing the efficient and economic operation of the system.

Transparency

We consider that it is important for there to be transparency in the provision of information in relation to the BM Start-Up service. This is to ensure that participants are aware of NGET's utilisation of the service and the costs involved, enabling participants to make informed decisions with respect to, for example, pricing Offers in the BM. We believe that the information provision and the improvement to the SONAR service proposed as part of these revisions will provide market participants with a clear understanding of when the BM Start-Up service will be utilised and the costs associated with the service. In this context, one variant of the proposed revisions to the PGs suggests the publication of the hourly BM Start-Up payment rate after an instruction has been issued or revised. We agree with those respondents who considered that this information would provide additional transparency surrounding the costs associated with the service, which should help aid competition in the provision of BM Start-Up services. As such, we support this variant of the proposed revisions to the PGs.

Contract design

We have not focused on specific issues associated with the contract as they do not form part of the C16 consultation or our decision upon the proposed revisions.

Decision notice

In accordance with special condition AA4.6 (b) (iii) of the Transmission Licence), the Authority agrees that NGET may modify the PGs, BPS, and the BSAD Methodology Statement in line with Appendices A1, B and C of the Authority Report respectively.

The Authority agrees that the revisions to the BPS, the PGs and the BSAD Methodology Statement should take effect from 1 November 2006 or such later date as shall be specified by NGET and notified to all interested parties as being the date upon which all necessary systems to enable implementation have been deployed successfully.

Yours sincerely



Sonia Brown
Director, Wholesale Markets

Signed on behalf of the Authority and authorised for that purpose